A5173-5.2F 10/89

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RESEARCH BULLETIN

Facing Up To Postretirement Health Benefits

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September 1989

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Executive Summary

Employer-provided health costs have increased rapidly in recent years, and retiree health costs have not escaped this plight. Recently proposed accounting standards may further burden employers as they face the magnitude of their future retiree costs. Also at issue is the aging of the population. Americans are living longer and thus will receive retiree health benefits longer.

This bulletin examines the current state of retiree health plans and discusses changes employers are considering to reduce their liability. The source of data is a survey conducted in 1988 by the Health Insurance Association of America (HIAA) and Johns Hopkins University.

Study findings indicate that retiree health costs and plan provisions are similar to those of active employees. Contrary to some fears, most employers are not considering eliminating retiree benefits completely. The most likely future plan changes will be to increase retiree contributions for premiums, increase cost sharing, expand the use of managed care plans and tighten eligibility for future retirees.

Facing Up To Postretirement Health Benefits

Retiree health benefits are steadily becoming a more significant portion of the costs of employer-sponsored health plans. Because of escalating costs, many businesses are considering limiting their liability for retired workers' health care.

Several factors make postretirement health benefits (PRHB) one of the most vexing promises employers have made to employees. Two are preeminent: the accelerating cost of health care and the aging of the population. Other factors driving up PRHB costs are expensive new medical technology and the demand that the technology be used without restraint.

The graying of America threatens the solvency of Medicare and employer-sponsored health plans. Even if health care costs could be contained, the sheer numbers of elderly people dictate that PRHB costs will be a greater share of the health care pie. Complicating matters has been the increase in the number of employees who retire before age 65 as firms attempt to reshape their work forces.[1] In 1950, working age Americans outnumbered people 65 and over by seven to one. Today this ratio is four to one. By 2030 , it will be about two to one.[2] With fewer employed workers to finance the cost of the retired population, costs per employee will skyrocket for firms providing PRHBs. Moreover, Americans are living longer. By 2030, enough people will be age 100 or more to create three generations of Medicare recipients.[3]

Recent proposed changes in accounting standards rather than demographic trends have brought the cost of PRHBs to the forefront. In February 1989, the Financial Accounting Standards Board (FASB), an accounting standards body, proposed new rules that would require employers to show future costs of postretirement benefits on an accrued basis.[4] Presently, most employers show current retiree expenses only on a pay-as-you-go basis. For some companies this cost may now be their greatest single liability.[5] The Employee Benefits Research Institute (EBRI) estimates the amount of this unfunded liability for private employers at $169 billion.[6] While this is not a new cost, it illustrates a liability that most firms have yet to confront.

◆ Development of PRHBs

PRHBs became popular in the mid-1960s when Medicare was instituted. Because Medicare did not cover all health care costs, businesses and individuals began to supplement Medicare with coverage for uncovered services.

Employers began offering PRHBs partly because of concern for the long-term health of their workers and partly because it was a less expensive form of compensation than wage increases. At the time these promises were made, few foresaw the coming explosion in costs. Employers also believed that this promise of future benefits depended on the welfare of the company and could be easily modified or retracted.[7] Subsequent court cases, such as *Eardmon vs. Bethlehem Steel* (1984), have largely dispelled this notion.[8] However, there is no consensus among the courts regarding retiree benefits. The pendulum may now be swinging back in favor of the employers. Recently a New York court held that Metropolitan Life Insurance Co. could increase retiree deductibles and take other actions despite promises in company newsletters of lifetime benefits at no cost.[9] In 1986, the Bureau of Labor Statistics estimated that 76 percent of full-time participants in health plans of medium and large employers had continued health care coverage after retirement.[10]

◆ Survey Methods

In 1988, the Health Insurance Association of America (HIAA) and the Johns Hopkins University surveyed employers concerning the types of health benefits offered to active employees. The completed sample represented a national survey of 1,665 randomly selected employers who offered health insurance benefits. The sample included both private and public firms, excluding union and federal government employees. The response rate exceeded 70 percent.

We then reinterviewed private firms that indicated current coverage of retirees.[11] The retiree survey included questions about eligibility, premium costs, cost sharing, cost-containment provisions and coordination with Medicare. We completed 327 interviews of the firms that provide retiree health benefits — a response rate of 84 percent. Westat, a Maryland-based survey firm, conducted the interviews. The average interview time was 10 to 12 minutes. We applied weights to the findings to derive national estimates for the U.S. population of retirees covered by employer-sponsored group health insurance.

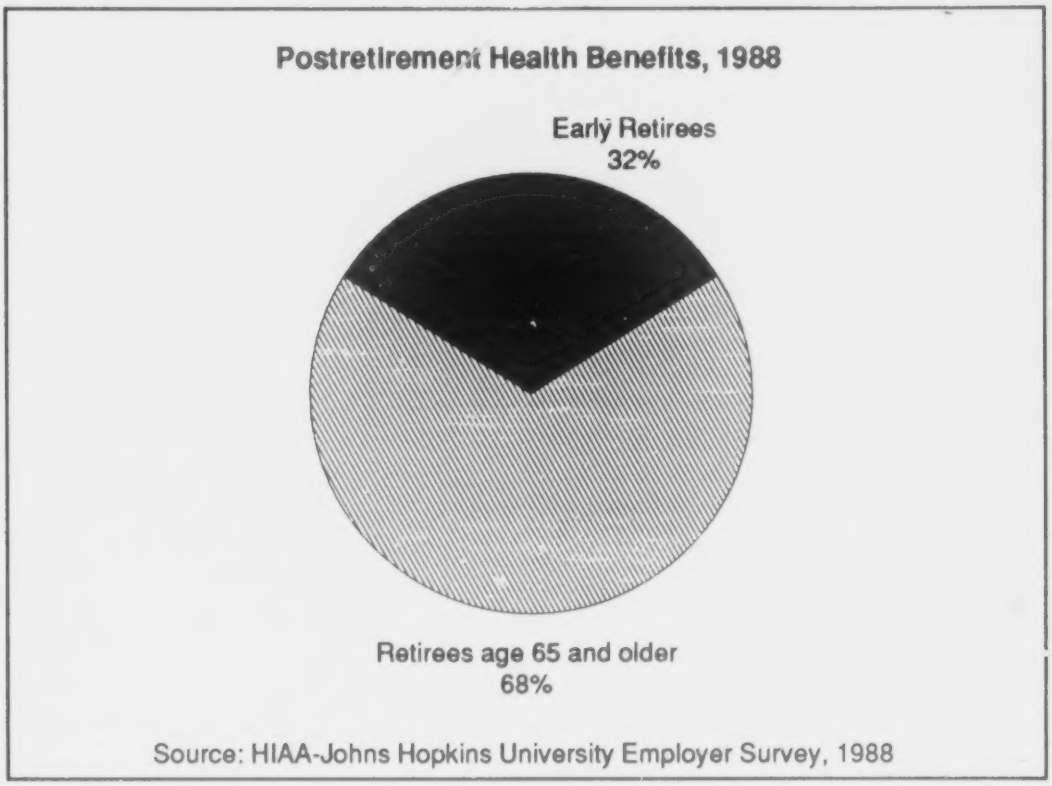

Figure 1

◆ Survey Findings

Corroborating findings of other surveys, we found that retiree benefits were similar to active employee benefits.[12] The average number of retirees covered by each firm in our survey was 2,079; however, more than 50 percent of these companies provided benefits for fewer than 200 retirees. The number of retirees covered ranged from one to 75,000. Of the retirees currently covered by PRHBs, 32 percent were early retirees, and more than two-thirds were age 65 and older (see figure 1). The average length of time employers have offered PRHBs was 21 years. Firms that offer these benefits tended to be well established with only 5 percent having been in business for 10 years or less.

Seventy-five percent of the plans required a defined number of years of service before an employee was eligible to receive retiree health benefits, usually the same as required for a pension (see figure 2).

The overwhelming majority (88 percent) of retirees were enrolled in conventional fee-for-service plans; 8 percent were enrolled in preferred provider organizations (PPOs) and four percent in health maintenance

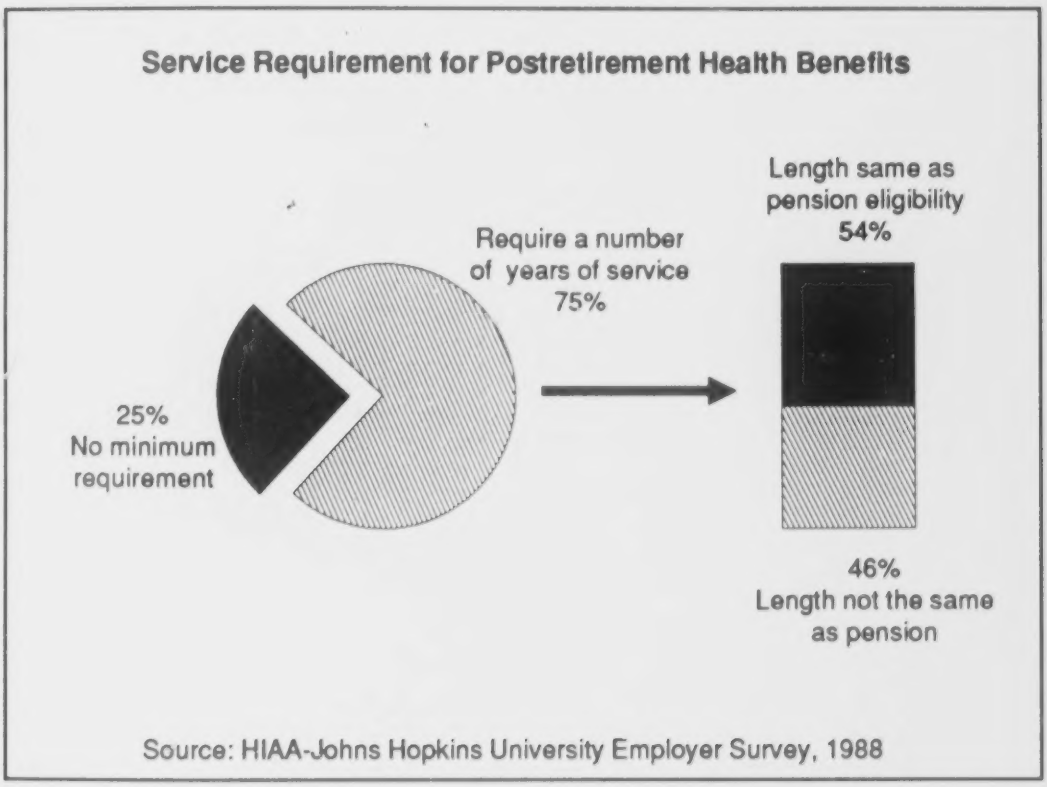
Service Requirement for Postretirement Health Benefits
Length same as pension eligibility 54%
Require a number of years of service 75%
25% No minimum requirement
46% Length not the same as pension
Source: HIAA-Johns Hopkins University Employer Survey, 1988

Figure 2

organizations (HMOs) (see figure 3). Of the active employees, 11 percent were enrolled in PPOs and 18 percent in HMOs. Most retirees (94 percent) were covered by the same plans as active workers.

Retiree Costs

The average monthly premium cost for retirees age 65 and older is similar to that of active employees: single coverage for retirees was $100 and family coverage cost $207.[13] Employers contributed 85 percent of the single premium and 77 percent for the family premium (see figure 4). Six percent of the retirees paid their premium in full; 44 percent contributed nothing toward their premium. The average rate of increase in premiums between 1987 and 1988 was 12 percent. A large majority (87 percent) of retiree health plans had premium increases in 1988. One percent had a decrease, and 12 percent showed no increase over 1987 (see figure 5).

Retirees differ significantly from current workers in first-dollar coverage payment. More than 40 percent of the retirees covered faced no deduct-

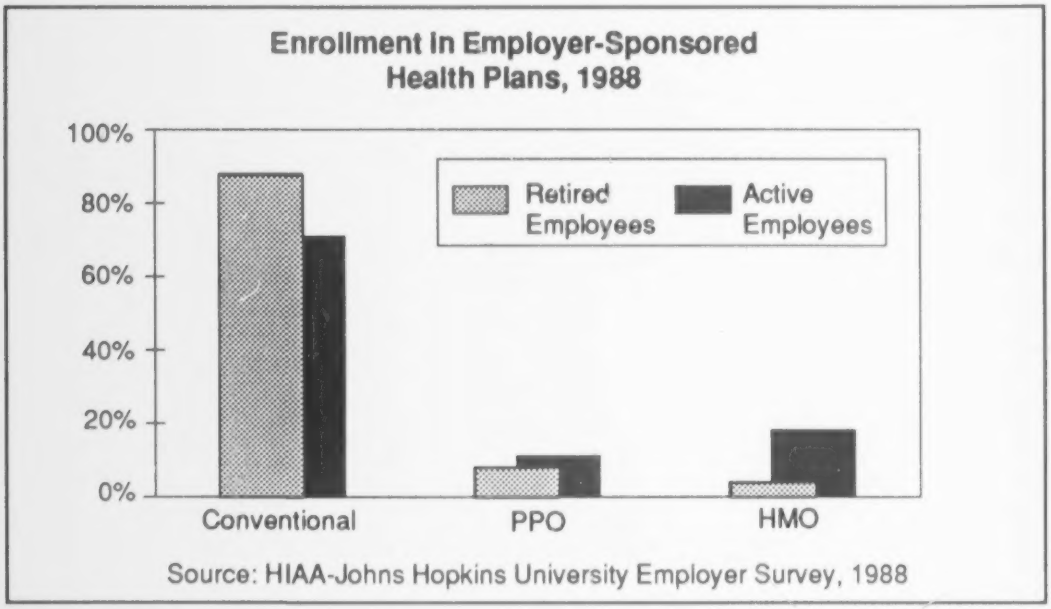

Figure 3

ibles compared with 4 percent of active employees. However, for those who did, the median deductible was $150 for single and $250 for family coverage. This compares to $150 for single and $300 for family deductibles paid by active enrollees.

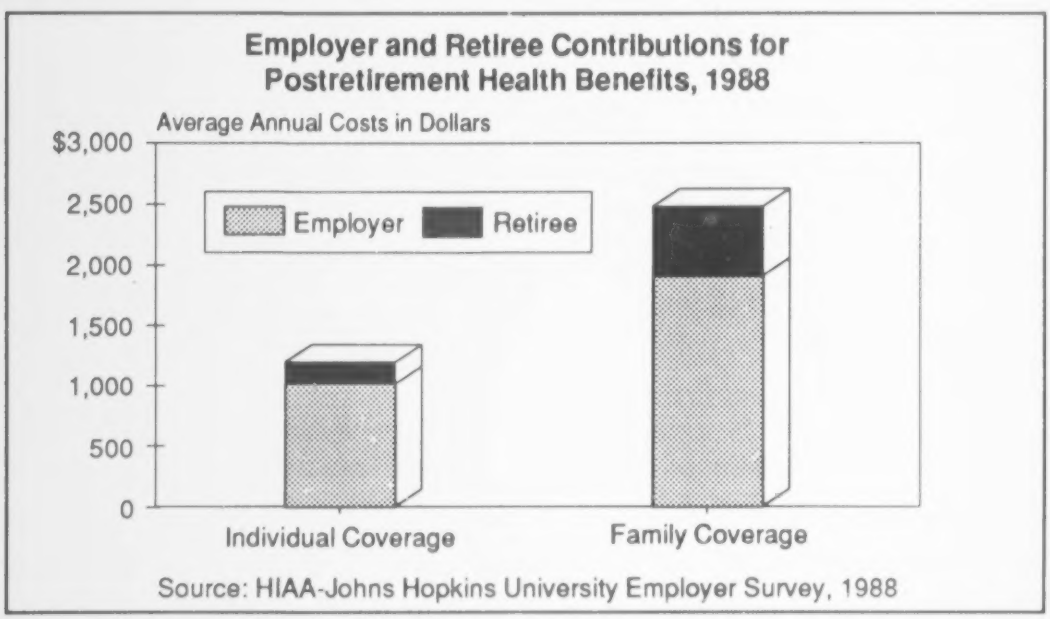

Figure 4

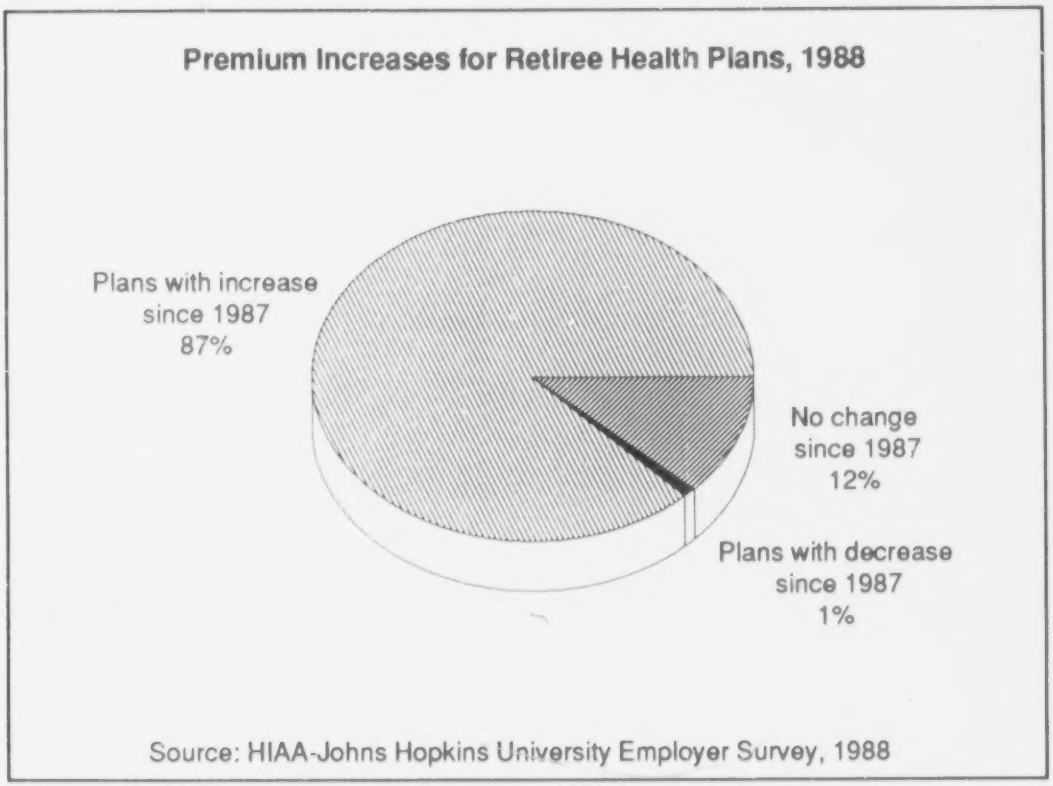
Premium Increases for Retiree Health Plans, 1988
Plans with increase since 1987 87%
No change since 1987 12%
Plans with decrease since 1987 1%
Source: HIAA-Johns Hopkins University Employer Survey, 1988

Figure 5

Benefits

A large majority of retirees (84 percent) received the same benefits and coverage levels as active enrollees. Of those with different levels, just about all received reduced benefits (2 percent received better benefits). Our survey targeted benefits most often needed by retirees, and we found that: 94 percent of retirees were covered for prescription drugs; 91 percent had home health care coverage; 73 percent were covered for hospice care; and 66 percent were covered for skilled nursing care (see figure 6).

A relatively unknown area in PRHBs is the extent to which retirees are subject to cost-containment provisions. Our survey indicates extensive cost management activity. Since retirees were enrolled in the same plans as active employees, they were most likely subject to the same restrictions and compliances. Table 1 illustrates the prevalence of each type of cost-containment provision.

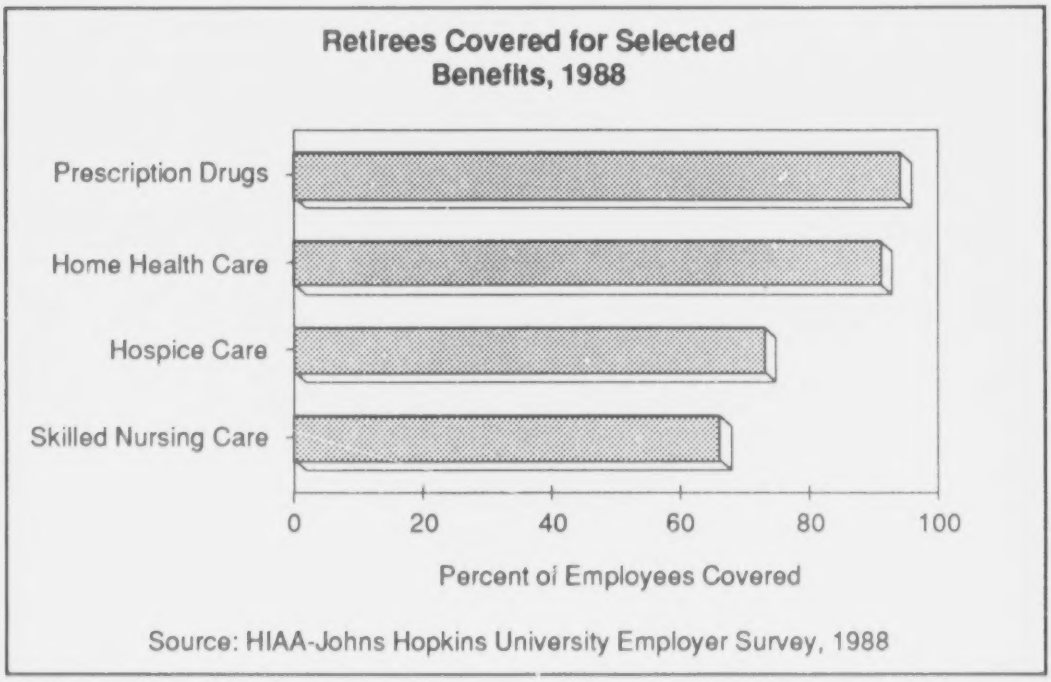

Figure 6

Coordination with Medicare

The amount that firms pay for benefits of retirees age 65 and older is usually determined by linking coverage to what Medicare will pay. We asked employers about how they coordinated their plan reimbursements with Medicare (see figure 7). Retirees were most often enrolled in a Medicare carve-out plan (74 percent), where benefits payable are reduced by the amount of the Medicare payment. The second most com-

Table 1 Cost-Containment Provisions in Postretirement Health Plans, 1988

Provision	Percent of Plans
Concurrent Utilization Review	78
Preadmission Certification	76
Case Management for Large Claims	74
Second Surgical Opinion	61
Generic Drugs	19

Source: HIAA-Johns Hopkins Survey, 1988

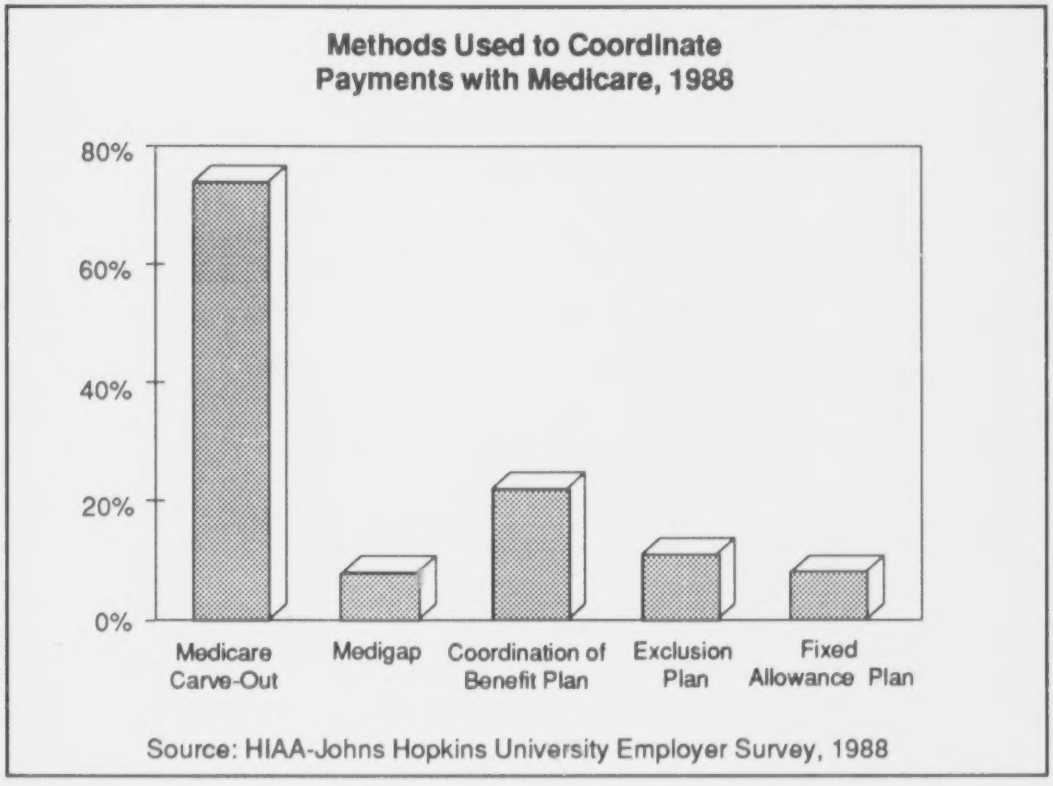

Figure 7

mon plan was coordination of benefits (22 percent), where Medicare payments are applied to the plan's deductible and coinsurance requirements and the employee generally pays no out-of-pocket cost. Exclusion plans (11 percent) were the third most frequently used. This is where a plan subtracts Medicare payments from the total claim before applying deductible and copayment provisions. Medicare supplemental plans, those that pay only Medicare deductibles and copayment amounts, accounted for 8 percent. Fixed benefit allowance plans that pay for only specific items or services not covered by Medicare also accounted for 8 percent.[14]

In addition to coordinating with Medicare, our survey reveals that employers paid the full cost of Medicare Part B premiums for more than 40 percent of their retirees. Employers also contributed the total amount of Part B premiums for 34 percent of retiree spouses.

◆ Plan Changes Under Consideration

As health care costs continue to grow and impending regulations and legislation prove burdensome to employers, many analysts predict that

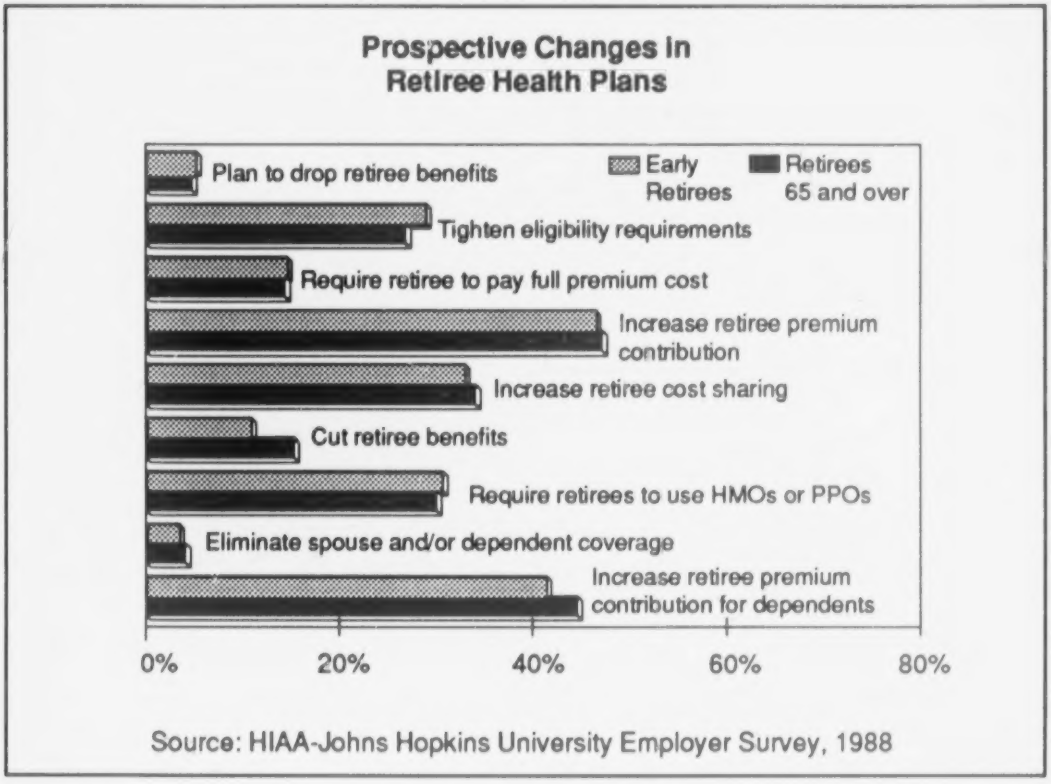

Figure 8

firms will make drastic cuts in benefits or eliminate PRHBs altogether.[15] The HIAA-Johns Hopkins Survey asked employers if they plan to drop coverage or if they were considering plan changes. Employers were asked separately about plan changes for current and future retirees age 65 and older, and for early retirees. We found the plan changes for both groups of retirees to be basically the same in most cases.

Contrary to some forecasts, few employers were planning or considering dropping retiree health coverage altogether (see figure 8). Of the firms currently offering PRHBs to retirees age 65 and older, less than 5 percent were likely to discontinue offering benefits for future retirees. For early retirees, slightly more were unlikely to continue benefits for future early retirees. We asked if they were considering eliminating spousal or dependent coverage. Only 4 percent were considering this for retirees age 65 and older; less than that were considering this elimination for early retirees. Thus, including employers that plan to drop retiree coverage altogether, roughly 9 percent of the firms surveyed were considering eliminating dependent coverage. There will, however, be changes in the way retiree benefits are structured. Among them are:

- *Increasing retiree contributions for premiums.* Of the firms that do not require retirees to pay the full cost of their coverage, more than half (55 percent) said they will require future retirees to pay a greater share or all of the premium. Sixteen percent anticipate requiring retirees to contribute the full cost. Similar findings were seen with retiree contributions for spousal or dependent coverage.
- *Increasing retiree cost sharing.* One-third of the employers planned to increase retiree cost sharing by instituting higher deductibles and coinsurance rates.
- *Expanding the use of managed care plans, such as HMOs and PPOs.* Of those firms that do not currently make these plans available to retirees, 40 percent said they were planning or considering this for early retirees. Thirty-six percent indicated this as a possibility for older retirees.
- *Tightening eligibility.* Three out of 10 employers said they were planning or considering tightening eligibility, such as changing the minimum number of years of service.

Employers were reluctant to reduce or cut current benefits. Only 15 percent were planning or considering reducing benefits for future retirees age 65 and older. Slightly more than 10 percent will take this action for early retirees.

There is much uncertainty and volatility in the courts regarding promises employers make to employees about benefits. At issue is whether firms have made contractual agreements with employees and to what extent the promised benefits should provide coverage. Thus far, the courts have ruled both ways concerning these issues. Given this uncertainty, experts speculate that employers will be leery of changing the health plans of current retirees.[16] However, our survey revealed that 16 percent of employers plan to change the health benefits available to current retirees.

◆ Outlook for Retiree Health Costs

Rising health care costs and the expectation of having to account for future retiree expenses have many employers considering options to reduce their liability for PRHB plans. Based on our survey, the two most likely strategies are managed care and increasing the amount that retirees pay for their own care. More and more firms are making available HMOs and PPOs for their retirees. While this is still mostly voluntary, financial incentives alone are likely to make these plans the only choice in the future.

According to our survey, firms are beginning to think about and implement increased cost-sharing requirements by retirees in the form of greater employee contributions for premiums and higher deductibles and coinsurance rates. This has the double effect of immediately reducing employer outlays and subsequently reducing employee utilization.[17] Due to high levels of employer contributions, most Americans do not have a true sense of what their health care costs.[18] There is little financial reward for many employees to seek efficient providers and health plans or to question potentially unnecessary treatments by hospitals and physicians. Requiring retirees and employees to pay more of their own health costs may help remedy this.

Yet even if health care costs can be controlled, what can be done about the graying of America? As the baby boom generation moves through its midyears, more Americans are retiring while fewer children are being born. How can society avoid the inevitable financial burden this presents?

One solution is to set aside funds now to pay for future costs. FASB has made a small step in this direction by proposing that employers calculate and report their future liability for retiree benefits. While the proposal stops short of dictating how the obligation is to be funded, the first step must be an understanding of what that expense may be.

Another approach to the problem is for employers to curtail early retirement to at least partially offset the anticipated shortage of new, younger people entering the work force in the next few decades.

Finally, keeping people healthy will reduce health care costs. By introducing wellness programs, employers like Johnson and Johnson and Quaker Oats are encouraging a healthier, more active and less costly work force.[19] While these programs have been geared toward active employees, in the future they can be focused on retirees as well.

If the current generation does not plan wisely for its retirement health costs, this financial burden will inevitably pass to the next generation. However, there will be many fewer workers available to support the ever-increasing number of retirees. Fortunately, at least for the moment there is time to plan a response. The political, economic and social agendas of the coming decade must address this and other issues associated with the cost of retirement so that today's workers can have a comfortable retirement with the expectation that their children's standard of living will continue to rise.

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1. Early retirement programs tend to increase employer health costs because the PRHB expense is carried by a smaller active employee base and results in more administration and higher fixed costs. For more details, see J. Dopkeen, "Postretirement Health Benefits," *Health Services Research*, February 1987, Vol. 21, No. 6, pp. 802-803.

2. U.S. Department of Health and Human Services, press release, July 29, 1988.

3. Remarks by Otis R. Bowen, Secretary of Health and Human Services, National Conference of Americans for Generational Equity, July 29, 1988.

4. For an executive summary of the proposal, see "Executive Summary of FASB Exposure Draft on Accounting for Post Retirement Benefits," *Spenser Research Reports*, December 1988. The complete draft is also available from FASB.

5. J. Norman, "Retiree Benefits: This Footnote Doesn't Have to Become a Nightmare," *Business Week*, Feb. 27, 1989, p. 39; D. Shalowitz, "FASB's Effect on Profits Illustrated," *Business Insurance*, Feb. 20, 1989.

6. *EBRI Issue Brief*, Employee Benefits Research Institute, November 1988, No. 84.

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8. In the Bethlehem Steel case, the corporation attempted to change the retiree health plan. The district court ruled that the employer did not clearly retain the right to modify or eliminate these benefits. Bethlehem Steel eventually settled the case, obtaining the plan modifications and establishing a permanent retiree health plan. For additional court cases, see *EBRI Issue Brief*, Employee Benefits Research Institute, November 1987, No. 47.

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10. Bureau of Labor Statistics, "Employee Benefits in Medium and Large Firms, 1986," U.S. Department of Labor, Washington, D.C., June 1987, Bulletin 2281.

11. Our data represent employers that currently cover retirees with PRHBs. Most other surveys report benefit levels and cost-sharing features for firms offering PRHBs.

12. Bureau of Labor Statistics, "Employee Benefits in Medium and Large Firms, 1986," U.S. Department of Labor, Washington, D.C., June 1987, Bulletin 2281. Consulting firm studies also confirm this.

13. For more details on the cost of active employees, see J. Gabel et al., "Employer-Sponsored Health Insurance in America," *Health Affairs*, Summer 1989, Vol. 8, No. 2, pp. 116-128.

14. Plan names and definitions usually vary from survey to survey. The definitions should be used for comparison purposes.

15. A. Bennett, "Firms Stunned by Retiree Health Costs," *Wall Street Journal*, May 24, 1988; J. Geisel, "Accounting Rules Will Trigger Retiree Health Plan Changes," *Business Insurance*, Feb. 20, 1989; F. Swoboda and A. Crenshaw, "Accounting Changes May Force Benefit Cuts," *Washington Post*, Feb. 14, 1989; I. Ness, "Critics of New FASB Rule Predict Benefit Cutbacks," *National Underwriter*, Feb. 20, 1989.

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